INTERNATIONAL FINANCIAL INSTITUTION LENDING TO ASIA AND THE PACIFIC: IMPLICATIONS FOR U.S. INTERESTS

HEARING

BEFORE THE

SUBCOMMITTEES ON

INTERNATIONAL ECONOMIC POLICY AND TRADE

AND

ASIA AND THE PACIFIC

OF THE

COMMITTEE ON INTERNATIONAL RELATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

SEPTEMBER 12, 1996

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INTERNATIONAL FINANCIAL INSTITUTION LENDING TO ASIA AND THE PACIFIC: IMPLICATIONS FOR U.S. INTERESTS

THURSDAY, SEPTEMBER 12, 1996

House of Representatives,
Committee on International Relations,
Subcommittee on International Economic Policy and Trade,
Subcommittee on Asia and the Pacific,
Washington, DC

The subcommittees met, pursuant to call, at 2:04 p.m. in room 2200, Rayburn House Office Building, Hon. Doug Bereuter (chairman of the Subcommittee on Asia and the Pacific), presiding.

Mr. Bereuter. The subcommittee will come to order. Despite rapid economic growth and privatization, the Asia-Pacific region remains home to two-thirds of the world's poorest people.

For several decades national governments have pulled their resources into international financial institutions to provide concessional and market rate loans to assist these countries in their transition to free market economies.

Today we are going to take a look at the international financial institutions, their lending to Asia and the Pacific region and the implications for U.S. interests.

This is, both Mr. Roth and I understand, within the jurisdiction of the Banking Committee. We do not feel too bad about having the hearing today. We think it is important that we have it, since this is the Asia Pacific Subcommittee.

Additionally, both Mr. Roth and myself serve on the Banking Committee. So an opportunity for us to investigate something and as a matter of fact, the Banking Committee subcommittee chairman, Mr. Castle and his staff have been informed and have been helpful in establishing this hearing.

The international financial institutions that lend to the region of course are the World Bank and the Asian Development Bank. Appropriately these institutions have traditionally made poverty alleviation their first priority goal.

For example, the concessional loan window of the World Bank, IDA, lends mainly to countries whose per capita income is below $865 a year.

Some critics of these institutions argue that international financial institution lending pales in comparison to private sector capital flows and is marginally effective in promoting sound economic policies in those countries.

However, others strongly believe that the World Bank and the Asian Development Bank lending is a catalyst for the private sector capital and therefore constitutes one of the country's best leveraged foreign aid investment.

Today we hope to tackle this issue as well as a wide variety of related issues in the limited amount of time we have available.

In doing so we hope to examine recent developments such as the chronic problem of U.S. arrearages and the threat of U.S. firms being shut out of procurement opportunities at these institutions.

Moreover we hope to cover regional lending trends and the graduation of various countries, like India and China, from the concessional loan windows.

To assist us on this overly ambitious task we are delighted to have for our first panel the Honorable David Lipton, Assistant Secretary of the Treasury for International Affairs.

Mr. Lipton is responsible for the day-to-day management of U.S. participation in the multi-lateral development banks. The executive directors and you are in close contact, I am sure.

Although most of Mr. Lipton's treasury experience has focused on privatization reforms in eastern Europe and the former Soviet Union, we note that from the Internet that he analyzed Japanese economic policy making as a senior economist at the International Monetary Fund.

For our second panel we are pleased to have Mr. Robert O'Quinn, policy analyst and economist at the Heritage Foundation. Mr. O'Quinn has testified once before us on the remarkable private sector renaissance in New Zealand and he now offers us his invaluable perspective on whether the international financial institutions can contribute to such policies throughout Asia.

Mr. Barry Hager of Hager Associates is former staff director of the House Banking Subcommittee on International Development Finance Trade and Economic Policy. He advises clients who invest and participate in World Bank projects.

Finally we have pulled Mr. Terry Newendorp, president of Taylor-DeJongh from important negotiations to lend us his 25 years of experience and expertise in international capital project development and financing.

Mr. Newendorp is not the usual witness, rather he spends his time closing deals and has done so, I understand, in 50 countries with transactions aggregating well over $10,000,000,000 in the developing world.

I turn now to Mr. Roth, if he has any opening statement.

Mr. ROTH. Well, thank you, Mr. Chairman. As you said, we are both members of the Banking Committee and quite frankly we have passed so much legislation by the Banking Committee this session that if we passed something else they would not even notice it with all the legislation that has been passed.

Let me join——

Mr. BEREUTER. That is a little bit of sarcasm there for the uninformed.

Mr. ROTH. Let me join Chairman Bereuter in welcoming our witnesses today. We are conducting this joint hearing to examine international development lending in Asia.

The United States is a major shareholder in both World Bank and the Asian Development Bank. The key question as I see it before us today is basically do the lending policies of these institutions contribute to the goals of our U.S. goals in Asia.

In particular, do we want to examine the so-called concessional lending by these banks. Why are India and China still eligible for concessional loans from the World Bank? In effect, these are giants.

You know they just released the 15 biggest exporting countries in the next ten years and China and India are both on there. After all, India and China are economic giants.

The resources of these banks are limited. There is also a fundamental question as I see it. Asia has the most dynamic economy of any area of the world today.

In 25 years Asia will account for more than half of the top ten economies in the world. What then is the mandate of these developed banks in Asia in the future, especially as far as the concessional lending is concerned?

These are important questions which we, as major shareholders must pursue and I look forward, Mr. Chairman, to the expert testimony today and have a chance to ask a few questions.

Mr. BEREUTER. Thank you very much, Mr. Roth.

First we would like to hear, of course, from Secretary Lipton. Mr. Secretary, your entire statement will be made a part of the record. You may proceed as you wish.

The House would appreciate it if you could keep your oral comments down to about 10 minutes so that we could ask questions.

STATEMENT OF HON. DAVID A. LIPTON, ASSISTANT SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY

Mr. LIPTON. Thank you, Mr. Chairman. I will just make a shorter statement than what I am submitting for the record.

It is a pleasure to appear before the subcommittees today to speak on international financial institution lending to Asia and implications for U.S. interests in the region.

These institutions have been active in the region for decades, supporting policy improvements and financing development, but the sweeping changes in Asia and the globalization of markets, the road of the IFI's is changing.

Today I will discuss the three critical roles for the IFI's in Asia. To address the serious poverty needs of the area, to encourage market-based policy and to encourage a stronger role for private sector activity.

But I will also stress that we must seek improvements in our international financial institutions so that they can be as modern as the markets in their member country.

Let me begin by placing the discussion in the context of Asia's recent economic development, some of which you have already mentioned.

With average annual GEP growth over the past two decades of about 7 percent per year, developing Asia has seen its economy quadruple in size during a period in which Latin America did not even double.

While it is true that exports have played a key role in Asia's economic development, the steady improvement in living standards have created a huge and dynamic new market demand for imports as a result.

By total volume, developing Asia's imports have grown sevenfold over the past three years comparing to a mere doubling of imports in Latin America during the same period and this year it is expected that Asia will import over a trillion dollars worth of goods and services for the first time.

This explosion of trade has benefitted not only from the international financial institutions' support for developing in the region, but also importantly from the steady policy conditionality aimed at creating more open trade systems there.

With a potential market of nearly three billion people, developing Asia represents an enormous economic opportunity for the United States and one to which U.S. business is responding. Last year U.S. businesses shipped $115,000,000,000 worth of exports to developing Asia.

The reasons behind Asia's past and continuing economic success are varied, but the common factor is that Asia started from a very low base in terms of output per capita and pursued economic policies that promoted stability and growth.

Public sectors have been kept small, fiscal deficits have been kept under control and monetary policies kept inflation down.

Macroeconomic policy has been supported by a strong commitment to future growth reflected in strong investment in human and fiscal capital, including infrastructure.

The region has also had an impressive record of consistently high domestic savings. With the region's aggregate savings rate in excess of 30 percent throughout the 1990's, developing Asia has been able to invest in itself year after year.

Turning to the IFI's, the IMF, the World Bank group and the Asian Development Bank have quietly and steadily supported Asia's economic transformation from the earliest stages.

Although the more dramatic changes in many countries have occurred within the past 5 or 6 years, the IFI's have been actively providing policy advice and financing for some time.

The first of the IFI's roles that I would like to discuss is poverty alleviation. Despite the stunning economic success in some parts of Asia, large portions of the population still do not participate in the economy and have not benefitted from the transformation that is taking place.

More than half of the world's one billion poor people live in south Asia and many lack clean water, sewage, as well as basic health care and educational opportunities for children.

The key to the alleviation of poverty is equitable and self-sustaining economic growth. The countries that have grown rapidly are the ones which have adopted policies in the areas of health, primary education, including the education of girls and have integrated the poor into the formal private economy.

The means through which we can best promote sound policy in these areas is the World Bank's soft loan arm, the International Development Association (IDA) and the Asian Development Fund (ADF).

In 1995, 43 percent of IDA lending was directly targeted to help the poor around the world. The example of a successful effort in poverty alleviation support is Bangladesh's programs to include education programs, which has received substantial support from IDA, the ADF and other donors.

Over the past two decades primary school enrollment rate for young girls had doubled to 71 percent and now approaches the 83 percent rate for boys.

The second role for the IFI's is to continue to support economic reform. The IFI's have a solid record of accomplishments in linking their lending to concrete policy steps and thereby putting their weight behind needed reforms.

A notable example is IFI support for India. India began a comprehensive effort to reshape its economy at the beginning of this decade.

In 1991, faced with severe fiscal and external imbalances and unsatisfactory growth, the new government turned away from the planning approach that had been followed for decades and undertook the major task of stabilizing and liberalizing the economy.

This quiet revolution, which is still under way, has been supported by assistance and advice from the international financial institutions and has yielded impressive results in the area such as investment, trade, tax, exchange rate and financial sector policy.

This has boosted India's economic growth more than 6 percent in recent years. After decades of stagnation, U.S. exports to India are now rising sharply. In fact, they are up 44 percent last year alone.

The third role for the IFI's is to promote and work effectively with the private sectors. There are several aspects of this challenge.

The IFI's can help create a fertile environment for the private sector through policy-based lending, conditioning their loans on specific steps such as the divestiture of state-run enterprises, freeing up financial markets, enacting legal and regulatory reforms, liberalizing trade and investment regimes and opening up new opportunities in specific economic sectors such as telecommunications and transportation.

The IFI's can provide technical assistance to bring in the expertise needed to make these changes. The IFI's can also catalyze private investment directly through their selection of infrastructure projects, a broader use of guarantees and the development of new and innovative instruments aimed at attracting private investors to high-priority sectors, such as energy, transportation, communications and finance.

We can see the dynamic role that can be played by the IFI's by looking at the power sector in Asia, where the Asian Development Bank and the private sector have worked in partnership with impressive results.

One good example of this collaboration is the Asian Bank's work in the Philippines, where in the late 1980's debilitating power shortages had led to daily brownouts in major cities.

The Asian Bank in a series of operations, including equity investments, loans and support for a build-operate transfer arrangement helped jump start a public/private partnership to upgrade power capabilities. That partnership has involved major U.S. companies and has made brownouts a thing of the past.

In sum, we applaud the efforts and operations of the World Bank and the Asian Development Bank and Fund in Asia. At the same time, we do not want them now to rest on their laurels.

As I said at the outset, we want the IFI's to be as modern as the markets. That means adapting to changes in the region.

It means discarding policies and instruments that do not work in the new global market. It means developing innovative and effective new instruments and most importantly it means assessing their own effectiveness.

When we consider our contribution to the IFI's, our financial contributions to the IFI's, we need to appreciate how our contributions are leverages as the IFI's mobilize financial resources for international development from other countries and from private capital markets throughout the world.

The IFI's also increase the impact of their lending by encouraging more effective policy reforms in borrowing countries and by more innovative work with private sector entities.

Through their promotion of growth and trade openness, the United States has gained stronger partners in the global economy.

It is worth noting that U.S. exports to the five IDA graduates in Asia totaled $40,000,000,000 in 1995. I think it is difficult to see a more cost-effective way to advance high-priority U.S. interests in Asia.

We are committed to using our leadership roles in these institutions to ensure high quality, effective programs which ensure market-oriented development and a key role for the private sector. Thank you.

[The prepared statement of Mr. Lipton appears in the appendix.]

Mr. BEREUTER. Secretary Lipton, thank you very much for your testimony and your excellent summary of it. There is a lot of information in your testimony that is very valuable to us that you did not go over, of course, because of the time constraint that we have imposed upon you.

I was interested to see, for example, on page six you set out the three tenets which guide U.S. policy towards China. I do not know where you got those, but it is interesting. They are very succinct.

Mr. LIPTON. Those, you may not be surprised to learn, are State Department pronouncements on this subject from the mouth of Warren Christopher.

Mr. BEREUTER. I have not seen them so succinctly stated before. You have helped us in that respect.

I would like to ask you first if you think there are any different trends in lending and activity in the Asia-Pacific region that are notable, especially in comparison to the other regional development banks or to the World Bank's activities in other regions.

Mr. LIPTON. Yes. Well, I think it is an area where the IFI involvement and multi-lateral development bank involvement is changing and it is changing as the economies change.

As was mentioned in some of the introductory remarks, these are countries that are growing very quickly. They are increasing their access to international capital markets.

They are, if not completing, moving very far along in economic reform processes and the IFI's and the multi-lateral development banks are trying to respond to that.

That means that certain of the policy-based lending programs are finished, and focus shifts to promoting private sector/public sector partnerships, trying to catalyze more private sector involvement—that is, moving from areas where the private sector can do a perfectly good job by itself to those areas where that is probably not going to happen very soon and shifting also to a more concerted focus on poverty alleviation in some of the South Asian countries where poverty remains so overwhelming.

Mr. BEREUTER. So that facet of serving as a catalytic factor is more advanced in the region than it would be with the Inter American Development Bank or the European Bank for Reconstruction Development because we did not have the private sector there for the most part.

Mr. LIPTON. Yes, I think that is fair. I mean I think that the other regions are now following along, especially in Latin America and in Europe, but I think that the growth and the advanced access that Asian countries have to the capital markets have led the IFI's to be on the frontier.

Mr. BEREUTER. On this subject you said in your testimony the treasury wants MDB's to become more active in the area of working as catalysts for the private sector, of course, and you said they are responding.

With respect to the World Bank and the Asian Development Bank, does this mean that there is more activity through the international financial corporation and the multi-lateral investment guarantee agency?

Mr. LIPTON. Well, just on the raw scale of operations, the World Bank and IDA have been around longer, have large amounts of resources and so the scale of their operations continues to swamp what I have seen MIGA do. They are younger and smaller institutions.

I think also the other factor is that the IFC and MIGA really need to focus on places where the private sector cannot go in without guarantees and so I think while they are operating and are active in Asia, I think that Asia is not their most important focus.

I think other areas of the world where the private sector really does not have the kind of foothold are more their central focus, but they are active, they are working wherever they can find areas where the private sector is not yet able, for one reason or another, to go in by themselves so that they try to provide a catalytic support.

Mr. BEREUTER. We had a major reversal on the House floor yesterday with respect to OPIC. I should say a national effort that has its parallels in MIGA.

We are hoping that we can provide some better answers to some of our colleagues who, in my judgment, are not well informed about the advantages and necessity of investment guarantee agencies.

Mr. Roth will have more to say about that perhaps, although it is a subject we are not too happy about today.

With respect to the Asian Development Bank and your testimony, you indicate that the Treasury would like to make the regional banks self-sustainable or approach self-sustainability. How would you do that? What do you have in mind in that respect?

Mr. LIPTON. Well, in that regard we are talking about the concessional windows. The IDA window at the Bank and the ADF window at the Fund.

All thinking in this area is very preliminary and I do not want to suggest that there is more advanced preparation on this subject than in fact that there is.

But these two facilities now have very substantial loans outstanding and while there is a huge concessionality embedded in that, there are re-flows that will be available to both institutions over time.

For some of the reasons that Congressman Roth mentioned, of course we hope and expect that when many countries have graduated from IDA, including the five I mentioned in Asia, that others will graduate. So, we hope that the scale and the need will in some sense diminish over time, at least for this region of the world.

So, we are looking at ways in which the replenishments could be structured so that in conjunction with the re-flows there could be a sustained pattern of operation without further replenishments.

We do not know whether that is possible, whether that can work out, but it is something that we are looking into.

Mr. BEREUTER. Would you consider or are you considering borrowing from the capital reserves of the ADB?

Mr. LIPTON. I do not think that we have been looking into that, but I can talk also with our executive director and see whether that subject has been raised, but I do not believe so.

Mr. BEREUTER. I would like to know if you have a response on that, Mr. Secretary.

Finally, what is the Asian Development Bank's good governance program?

Mr. LIPTON. The Asian Bank is the first where a good governance policy has been adopted. It is something that we have sought and are very pleased to see.

We think it is important that when the banks lend that there be governance in the country that ensures that economic policies and social policies being supported by the bank will be affected and that the resources being devoted to these projects will be well spent. So this policy enables the Bank to examine the various criteria whether these conditions are satisfactory.

Mr. BEREUTER. Is that a forerunner? Is that a precedent-setting——

Mr. LIPTON. It is a precedent. I would say that in the other institutions there are elements of the good governance policy, while it is not labeled as such in the other institutions.

We have sought and achieved policies on transparency disclosure of project documents, consultation practices between the bank and the borrowing countries and various groups in the countries that we think will help promote better programs, more ownership, more openness about the operations that countries are engaging with, with the IFI's.

So there are, I would say, elements that touch upon this in the other institutions, but it has not been formalized as a governance policy overall.

Mr. BEREUTER. Is it a policy initiative that you are sufficiently satisfied with that you might cause the other U.S. executive directors in the MDB's to try to push for that kind of good governance policy?

Mr. LIPTON. I would not say that we are at a point where we are pushing for a specific policy to be adopted in other particular institutions, but it is an area where we are very interested to see our progress and we are eager to look this over.

In essence, there is not a decision yet. There is not a policy in this regard, but it is something that we are very interested in and in Asia where we are looking to see what palpable results we can point to from the policy that has been adopted.

Mr. BEREUTER. I hope you will remember my question on that as you think about emulating that policy.

Mr. Roth. Take as much time as you would like.

Mr. ROTH. Okay. I will try to be somewhat brief, because I know we have some other witnesses.

I was interested, you do a lot of work in Bangladesh?

Mr. LIPTON. I do not myself.

Mr. ROTH. The Bank?

Mr. LIPTON. The Bank? I am sorry. Yes. Both institutions, the World Bank through its IDA window and the ADB are very active in Bangladesh.

Mr. ROTH. You talk about economic growth. I just was looking at a statistic here. I am from the state of Wisconsin. We have 5.4 million people and we feel we are fairly crowded. Bangladesh is the same size as Wisconsin and they have 120 million people.

If all the people were the size of our two staffers here, nobody could sit down. They would all have to stand up.

I was wondering when loans are made, are these factors, these population factors, is anything being done in that respect? I know you put a lot of emphasis on economic growth, but it seems to me no matter how much economic growth you have with a population that is going to eat up whatever the growth may be.

Mr. LIPTON. Bangladesh is a country with many problems. As you point out, the population density is quite extreme. They have the problem that a very large fraction of the country floods on a regular basis and that breeds pestilence and other problems.

Much of the economy remains informal. People living in the subsistence fashion without any sort of engagement in trade or commerce.

The IFI's are focusing a lot of their energies on providing for basic human needs and poverty alleviation, but trying to do it in a way that brings sustained rather than temporal benefits. The education program that I mentioned I think is an example of that.

At the same time, the IFI's are trying to promote creating better government institutions and creating an environment in which there can be some business so that people can be brought into a formal economy, have jobs and engage in commerce.

I think you are very right in your suspicion that this country will be poor for a very long time and has extremely difficult challenges. It is among the poorest countries in Asia and the obstacles to decent living standards are very great.

Mr. ROTH. My question basically was, are those things being factored in. Let me ask you. You said that concessional loans are being paid back in the form of reforms.

How much is being paid back now? Are the banks willing to push for repayment? It seems to me that the mind set of these concessional loans is that they are really grants. Am I incorrect?

Mr. LIPTON. I think that every effort is made to try to determine whether the borrowing countries will be able to pay back the loan, albeit on concessional terms.

They have grant elements in that the terms of the loans, the low- or zero-interest terms and the very long maturities means that what the bank gets back is a lot less than they would have gotten if they had bought U.S. Treasury bills.

I believe it is India repaying on the order of $300,000,000 per year of repayments from past loans. In Asia the payments record is quite good, although appreciating that they are paying back loans with this grant element included.

There are other parts of the world where the payments record is not so good. In Africa in particular and where that is a problem for the World Bank for IDA as an institution.

Mr. ROTH. Thank you. I appreciate your answer. It just seems strange to me, for example a country like India with such gifted people and we are giving these concessional loans and yet they are becoming one of the chief economic powers in just a few years.

Mr. LIPTON. If I could mention on that point. You raised that also in your introductory comments. The U.S. Government has taken the view that China should not be receiving any concessional loans from the World Bank's IDA window.

A number of the other members of IDA have disagreed with that. We have reached a compromise where IDA 11, the next 3-year period of IDA, will by agreement be the last year in which China will be eligible to get concessional loans from the World Bank.

Our view is that we would like to see the borrowing stop, because we see that China has such substantial access to private capital.

India we consider to be somewhat different. India's access to the capital markets is both more limited and much more recently attained and in a sense untested.

India also has a significantly higher fraction of the population that is living in poverty from 250,000,000 people and there we consider that at present there is justification for continuing at a modest level or at some limits IDA loans.

I also wanted to mention that from the Asian Fund neither country has access to concessional loans. It is only from the IDA.

Mr. ROTH. Okay. Thank you.

Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you.

Your comments about Bangladesh are an interesting coincidence because today Mr. Berman and I introduced legislation focusing on water development, which you mentioned as a major problem.

Actually, as you know, cyclical flooding and drought plagues part of that area and we have 400,000,000 people living in the Ganges, Bamaputra River triangle with their tributaries in Nepal and India and Bangladesh.

So, we have two resolve clauses in the legislation which we have introduced just to give this issue more public attention.

The first is to urge the governments of the free countries to redouble their efforts to devise development projects that could relieve the poverty of these people living in the Ganges in Bamaputra River basin and address their critical problems of flooding and drought.

Actually this is the biggest concentration of the world's most poverty stricken people right in that region. By far the biggest concentration.

Second, to encourage the international financial institutions such as the World Bank and Asian Development Bank and international community to offer whatever assistance, advice, and encouragement is appropriate to help in this effort.

There are some encouraging signs, I think, between the Bangladesh and Indian Governments in that respect. So we hope perhaps that will get a little attention and still we do not want to be causing any difficulties by our interest.

Mr. LIPTON. We will follow that. I am glad to hear that.

Mr. BEREUTER. Thank you very much for your testimony. I appreciate your testimony, Secretary Lipton.

Mr. LIPTON. Thank you.

Mr. BEREUTER. I would like now to call the second panel and I have given some brief introductions for the three gentlemen that were to be on the panel.

I have just been informed as we have proceeded that Terry Newendorp is unable to be with us, unexpectedly. I guess when you push for people that are deal makers sometimes they are involved in those last-minute negotiations on infrastructure projects and that is what has been suggested.

We are happy to have the two witnesses who are with us today. Mr. O'Quinn and Mr. Hager. As I mentioned, Mr. Robert O'Quinn is a policy analyst for Heritage Foundation. Mr. O'Quinn, Mr. Hager, thank you for your appearance today.

Mr. O'Quinn, if you could summarize in about 5 minutes or so we would like to then ask questions of the two of you.

STATEMENT OF MR. ROBERT P. O'QUINN, POLICY ANALYST, THE HERITAGE FOUNDATION

Mr. O'QUINN. Thank you, Mr. Chairman, for inviting me to testify today. As a former congressional staffer, I know how much members appreciate brevity, particularly from the witnesses on a second panel so let me cut to the quick.

For the United States, the most important issue regarding the international financial institutions is whether they provide a cost-effective means of accelerating growth and development in least developed and transition economies.

Promoting economic growth abroad is an important American foreign policy objective. Of course economic growth abroad expands the market for U.S. exports and thus creates jobs for American workers.

However, economic growth has geopolitical as well as financial benefits for the United States. As we learned in the 1930's, economic stagnation and dislocation can breed instability that may directly threaten America's security interest. Promoting economic growth can lessen these tensions that might lead to conflict.

The record of international financial institutions in promoting growth and developing transition in least developed economies is not good.

Certainly some of the activities of the IMF and the multi-lateral development banks have been helpful. On balance however, they have not been a good bargain for American taxpayers.

The IMF is an international monetary institution established at Bretton Woods. After President Nixon's delinking gold from the dollar, the IMF's original mission was eviscerated and subsequently the IMF adopted two new missions, an international lender of the last resort to governments and an economic policy advisor to those governments.

Playing lender-of-last-resort role to over extended foreign governments may sometimes be necessary to avert an international financial crisis.

However, the IMF's policy advice has done the most damage to prospects for economic growth in the world. On one hand, much of the IMF's advice is consistent with free market principles.

For example, favoring deregulation, privatization and trade liberalization. On the other hand, the IMF emphasizes closing government budget and current account deficits.

Frequently this obsessions leads foreign governments to hike taxes in an often vain attempt to close these twin deficits. Higher tax rates may slow or even halt economic growth.

Certainly this reduces imports and narrows the current account deficit. However, the effects of slower economic growth and tax collections often overwhelms the effects of the higher rates, thus causing the budget deficit to rise.

Moreover, when the IMF pushes foreign governments to cut public spending and employment, recognizing of course that these reductions are desirable in the long run, these reductions may prove politically unpalatable in the short run when combined with higher taxes, recession and unemployment.

Thus the IMF's push for immediate budget deficit reduction may cause a populous backlash against the very free market economic policies that will producer higher economic growth rates over time.

Now let me briefly turn to the World Bank. In recent years a number of problems have beset the World Bank that raised serious questions about its financial solvency and its effectiveness in promoting economic growth.

The World Bank displays a key weakness that is invariably found in the post mortem of any failed financial institution, poor management controls.

In 1992, an internal report prepared for then president Lewis Preston found that the World Bank loan evaluations had "a systematic and growing bias toward excessively optimistic rate of return expectations at appraisal".

The World Bank had "an improval culture in which staff perceives appraisals as marketing devices for securing loan approval".

Moreover, the World Bank failed to monitor projects and enforce financial covenants on borrowers. Consequently the report found that one-third of the Bank's projects were failing and the quality of the bank's loan portfolio was steadily deteriorating.

The World Bank began to shift its portfolio from project financing to non-specific structural addressment loans during the third world debt crisis of the 1980's.

Those loans now comprise approximately one fifth of the IBRD's portfolio. While such loans may in theory facilitate a transition to a market-oriented economy, these loans too often are merely used to keep existing creditors at bay.

Moreover, the Reagan and Bush administrations used the IMF and the World Bank to advance funds to heavily indebted governments.

This allowed these governments to reduce their balances or even pay off their loans to private banks in Europe, Japan and the United States. Thus advances from the IMF and the multi-lateral developments gradually reduce commercial bank lending to those countries.

The World Bank has benefitted from the Paris Club, a regular meeting of indebted and lending countries sponsored by the French Ministry of Finance to renegotiate third world debts, and the IDA to maintain the appearance of the IBRD's loan portfolio.

Through the Paris Club the United States and other creditor governments have forgiven debts owed to them so that third world borrowers would not have to default on IBRD loans.

Moreover, the IDA has regularly advanced concessionary credits to ease the debt service burden of IBRD borrowers. Thus the World Bank channels foreign aid money from rich countries, like ourselves, through its subsidiary, the IDA, to heavily indebted developing countries that in turn use the money to pay the interest and principal on their loans from another World Bank subsidiary, the IBRD.

While such round tripping may forestall the day of financial reckoning, it does nothing to promote growth and developing these developed to transition economies.

Consider the following. Of the 66 less developed countries receiving money from the World Bank for 25 or more years, 37 are no better off today than they were before receiving such loans and of those 20 are indeed poorer today than they were before receiving the bank loan.

The key to economic development of the third world is private sector savings and investment, not foreign aid. Governments in developing, transition or even least developed countries need to get their economic policies right.

A low flat rate tax structure, a fair legal code, an impartial judiciary, reasonable regulations, stable money and borders open to international trade and investment all foster private sector savings and investment and thus accelerate economic growth.

International financial institutions have value to the United States only to the extent they advance these pro-growth policies.

Mr. Chairman, I thank you for your time and look forward to your questions.

[The prepared statement of Mr. O'Quinn appears in the appendix.]

Mr. BEREUTER. Mr. O'Quinn, thank you very much.

Mr. Hager is president of Hager Associates. Nice to see you. Even though it is a different committee setting it is the same subject in general.

STATEMENT OF MR. BARRY M. HAGER, PRESIDENT, HAGER ASSOCIATES

Mr. HAGER. Yes. I am delighted to be here.

Mr. BEREUTER. You may proceed as you wish and your entire statement will be made a part of the record.

Mr. HAGER. Thanks very much. I will summarize it briefly, since I share with my colleague at the table here the experience of having been staff with Chairman Bereuter in fact in the past. I appreciate it.

Mr. BEREUTER. Mr. Hager, I wanted to say after Mr. O'Quinn's comment about brevity being appreciated on the second panel that sometimes I think we learn more from the second panel.

We have good testimony from this and previous administrations, but sometimes you are more likely to give us the candor we need. So maybe we ought to put the second panel first and in any case, you are on.

Mr. HAGER. I will leave that to your judgment. I hope I can live up to your expectations or both of us can.

I would like to say that I am happy that the two of us share the same basic premise, which I think is the crucial premise and that is reflected in my written statement and that is simply that it is in the clear and direct interest of the United States to promote economic development abroad.

I share with both of you chairmen some degree of concern by the vote yesterday, but I think maybe that does reflect a division of opinion in the Congress on that question.

But I think it is indisputable that if we work over time it is not quick, it is not easy, but if we work over time to contribute to economic development and the reduction of disparities in wealth and income both within and among nations, that over time that contributes to global stability in ways that the United States, as the remaining global super power should consider to be clear and direct importance to our long-term national security interests.

That said, the second sort of premise of my remarks is quite simply that again it is something that is difficult to prove perhaps and one can certainly dispute it, but there are criticisms of the World Bank and other multi-lateral banks performances, specific cases, but overall the premise of my remarks is that the World Bank and the regional development banks and the IMF in a separate way have over time and will in the future contribute to that economic development, which leads to greater global stability.

For those reasons it is my judgment that the United States should continue to support and participate in these international institutions.

One of the quick sort of large points I wanted to make and then I would invite, if this is of any particular interest to you, maybe some questions on any of the particulars, one of the large points I would like to make is that the World Bank and the other multilateral bank's presence in these economies, especially where they are involved in funding various kinds of economic development projects has some other kinds of spin off benefits which I think can be improved upon and expanded, but nevertheless which are already there.

Those are sort of under the rubric, I think, of good government transparency. There are lots of ways in which if the World Bank and the other development banks are involved and again the IMF in a slightly different capacity are involved in these countries, they can encourage these countries, both the governments and also the private sector officials, they can encourage them to adopt practices which could be viewed as kind of best practices in a range of areas.

Let's say something like, for example, the procurement area. In these projects the World Bank has tried to put forward standards involving competitive bidding, which are all aimed at making sure that the system is fair.

That the best product and the best service is chosen and is purchased by the people involved in the project. That the procurement decision is not made based on favoritism or corruption of some kind.

So to the extent that the World Bank's involvement in these projects involves setting standards and encouraging compliance with these high standards, I think it improves the business climate for all the other business activities that take place.

So in that other somewhat less tangible way, it contributes long-term to the economic development on the growth of the private sector in these countries.

Related to that I would specifically suggest that one of the recommendations I have put in here is that the World Bank and the regional development banks try to do even more in terms of this issue of corruption.

It has been, I think, in the past a particular focus of the U.S. Government that we would like to eliminate corruption and elicit payments and so forth from the international transactions system.

It is not easy to do. We have taken steps in our domestic legal regime by having our own Foreign Corrupt Practices Act.

More recently I think the Clinton administration's Secretary Kantor and others have talked a lot about the importance of this issue and the OECD has focused a lot on this issue.

It strikes me again as an area where more canon should be done by the multi-lateral banks and over the long pull again efforts like that are conducive to creating the kind of business climate where business people can make investments and have some reasonable assurance that they are going to be treated fairly.

They are not going to be cheated. If they have done their own business planning correctly then they can make a profit and over the longer pull that encourages the kind of growth of the economy that we all seek.

Another recommendation, if I may, that I have highlighted in my written testimony, which I personally think is important, is that all of the IFI's need to focus more intently or intensively on the question of military spending.

This is not a comment restricted in any way just to the Asian region, but globally I think the problem of the military spending by developing countries is a problem. It is excessive to the extent that it draws away fungible funds from other development goals.

I think there has been activity, particularly the IMF in recent years, to try and look at that question and figure out what can be done about it.

But that is something that I think should be encouraged and I think the Congress should encourage the IFI's in that direction.

So Mr. Chairman, I will leave it at that and welcome any questions you might have.

[The prepared statement of Mr. Hager appears in the appendix.]

Mr. BEREUTER. Thank you very much.

Mr. Faleomavaega, do you have any questions you would like to start with? I would be happy to

Mr. FALEOMAVAEGA. No, I defer to you, Mr. Chairman.

Mr. BEREUTER. Very well. One of the things that Secretary Lipton said is that the institutions and I think he is referring to in the region at least, should focus more on serving as a catalyst for the private sector capital and more effectively promoting private sector growth. Nothing surprising about that.

However, also you testified that these institutions, especially the ADB, should not neglect its focus on the human capital development and environmental issues and population work.

Does this provide the MBD's with contradictory missions? Schizophrenia? Is there anything wrong with——

Mr. HAGER. I really do not think so, but if I could go to——

Mr. BEREUTER. If there is nothing wrong with schizophrenia in an institution just not in people.

Mr. HAGER. I will pass on that, but I do not think it really does, because again and I believe I even heard some of the same points expressed somewhat differently in my colleague's remarks as well.

If you really want economic development to occur, you have to encourage investment and trade and to do those things you have to have things like, we use these phrases but they are meaningful phrases, sanctity of contract, rule of law, dependable regimes where if you go in with your money and you make an investment or you are trying to make a sale, you have some reason to believe that you will be fairly treated and the terms of your agreement will be adhered to.

All of that requires in many cases institution building. So attention to the human dimension, education, training of judges, training of lawyers, however one might be lawyers in some context, all of these kinds of human pieces of the puzzle I think are very related to the fostering of private sector investment in these economies.

Mr. BEREUTER. Some people would say that particularly in Asia and the Pacific region that MDB lending is really irrelevant as compared to the massive private sector capital flows in the region.

What effect would you say, both of you, does MDB lending have demonstrably on private sector capital flows in the region? Do you have any good examples?

Mr. HAGER. Well, the quick point I would make and I am not sure there is any one example that stands out as better than another example, but I think generally speaking and I will refer to Secretary Lipton's reference to the power sector.

Certainly electric power generation is a sector where there is a lot of investment. A lot of these power projects are huge and no one investor is going to be able to take on the whole project.

Where the World Bank, through its various arms gets involved or the Asian Bank gets involved again it functions as a catalyst for other investors to get in, because there is a sense frankly that it is a safer deal.

Mr. BEREUTER. How often has that happened where you have a mixture of MDB and private sector lending in these projects?

Mr. HAGER. I think often.

Mr. BEREUTER. Most of the time? Part of the time?

Mr. HAGER. That is a specific statistical question I cannot answer, but my guess is we could get that answer for you from the World Bank folks.

I would say it happens frequently and with increasing frequency precisely because the magnitude of some of these deals is so huge that no one wants to take on all the risk.

They want to diversify the risk by having different players and that includes frankly people from Europe, from the United States, people from Asia as investors and the World Bank or the ADB presence in the deal gives everybody a little more comfort that the deal will be protected, people will be repaid in accordance with the terms of the deal.

Mr. BEREUTER. Mr. O'Quinn.

Mr. O'QUINN. I think the key element that an MDB can bring to the table is basically leveraging policy change in a borrowing government. This is true in the case of India, and this is true in the case of China. For example:

Building a legal infrastructure so that business can be conducted. Bringing transparency to the law making and regulating process. Development of an impartial judiciary to deal with commercial disputes.

All of this is basically something that we frankly in the United States take pretty much for granted and by using advancing funds to leverage these changes, that is the unique role that an MDB can play to the process that a Citibank or that any investment bank cannot bring to the table.

Mr. BEREUTER. An institution or governmental infrastructure.

Mr. O'QUINN. That is right.

Mr. BEREUTER. That can be provided of course by bilateral aid and is occasionally. What is the advantage of doing it through MDB?

Mr. O'QUINN. Well, I think the one advantage of going through a multi-lateral approach, particularly if you are talking about bilateral aid from the United States, is that it is very easy for the opponents of aid or the opponents of that policy change in a receiving country to picture the United States basically as the big bully coming to tell them what to do.

Because of our status as a super power, we can easily be painted and get very much of an anti-Yankee cinema, whereas if it is coming through a multi-lateral development bank, something that does not have the well known face of President Clinton or whoever the President is to point to and it has, if you will, this sanction of the world community, rather than just the United States, I think it is much more difficult to resist the change and much easier for a borrowing government to make those changes.

Mr. BEREUTER. I think frankly that is a good point to make here and I am glad that you were able to make that point.

Mr. HAGER. Mr. Chairman, if I could add to that.

Mr. BEREUTER. Yes.

Mr. HAGER. Maybe it is the same thought, but just slightly different. I get back to this notion of setting standards too.

If you take a particular issue like environmental standards, I think it is a little more likely that environmental standards are going to be pushed upward if there is a multi-lateral agreement, a multi-lateral approach on that, than if as my colleague says it is a matter of the United States trying to——

Mr. BEREUTER. Imposing its will.

Mr. HAGER. Perceived as imposing its own higher environmental standards, but if the world then goes in and says we have all agreed on this and we think that we are really not going to be able to help you build this power plant or whatever, unless you put certain kinds of air pollution reduction equipment on the plant, then that has a lot more authority and it is much more likely to help resolve the problem.

Mr. FALEOMAVAEGA. Will the chairman yield?

Mr. BEREUTER. I yield.

Mr. FALEOMAVAEGA. Thank you.

I was listening with interest as you mentioned about environmental standards. One of the most serious areas that I have seen in not only third world countries but what we are trying to do through these regional lending institutions, the most serious issue that I see is labor standards and the disparity of our own economic situation here in our country, the fear of jobs leaving our country.

American corporation community going to foreign countries simply because of cheaper labor. I just wondered if you can comment on this, because I notice Mr. O'Quinn is an expert on GATT and WTO and I have some very serious questions about this whole idea of free trade.

While I believe in free trade, I also believe in fair trade and what is your opinion about the idea that this whole global community is going to become one little nice family? Everything is going to be done on a competitive basis, but is it really going to be on a competitive basis?

I am really serious and concerned about the fact that the more we get tied into the WTO and the GATT, the more the Americans are going to lose their jobs. Not only in qualitative basis but in every way that I am seeing this corporate America is going to leave this country.

Tell me if I am wrong on this observation. I make this reference specifically to labor standards as a classic example where child labor (talk about abuse and the fact that these children literally are children), in some of these third world countries is perfectly acceptable. I am curious what might be your reactions to this.

Mr. HAGER. Well, I tend to agree that the issue of labor standards and working conditions is a crucial one and again I would put it in that framework that I have tried to put forward in my testimony and that is that the utility to the United States of the multilateral banks can be precisely that they can be used.

Obviously we do not control the banks, but we do have the single largest voting share in all the banks and we do and should attempt to exert our influence in them.

Mr. FALEOMAVAEGA. You mentioned earlier, Mr. Hager and I did not mean to disrupt your statement, the fact of the concern about the increase of the amount of military hardware being purchased by third world countries.

Well, it just so happens that the highest or the biggest sellers of military hardware are these very countries that are participants in these regional banks.

The United States. France. Russia. They are the biggest sellers of military hardware to these, making billions of dollars. So where do we see the fairness of the process?

Mr. HAGER. Well, I think you are absolutely right. Where there is a buyer there is a seller and so we have to look at both sides of the equation and again I would respectfully suggest that it is appropriate that these institutions, the IFI's, try hard to over time reduce the level of expenditure by these developing countries on military hardware.

If that means there is a reduced level of sales by U.S. and European and Japanese companies, then so be it and then——

Mr. FALEOMAVAEGA. The complaints now that the American corporate community is saying, you keep restricting us and now we cannot be part of the competition, because now the French companies are going to be there to put all the money in.

Mr. HAGER. If I could, Mr. Congressman, go back quickly to the question of labor standards again. I would just hope that the utility of these multi-lateral institutions is that they give us a mechanism to use; in fact to put upward pressure on wages and working condition standards, certainly in areas such as child labor.

Those are things that the MDB's ought to be opposed to and ought to find ways of prohibiting within the context of any project where World Bank or Asian Bank Funds are used. If we use those institutions in that way then progress can be made on that program that you have identified.

Mr. O'QUINN. Congressman, one thing that we do know and we know this throughout the world is that high-income countries and middle-income countries do a far better job of enforcing labor standards and protecting their natural environment than do low-income countries.

We know that if we look at particular countries of East Asia, starting with Japan and then now looking at Korea and Taiwan, as countries move up the income ladder and per capita income rises, internal political pressures are brought to bear to improve labor environmental standards.

One of the things that is very important is to maintain an open trading regime to allow low-income countries the ability to earn money through foreign exchange and through exporting goods and services to the point that they are not low-income countries any more, but they become middle-income countries.

At that point, there is tremendous pressure internally as well as externally to deal with labor and environmental problems.

Mr. FALEOMAVAEGA. Mr. Chairman, I am sorry. I did not mean to enter your time. One more question.

You know there was an article in the Wall Street Journal about Asian factories being built along the Mexican/U.S. borderline by the droves.

I mean they are investing billions of dollars right along the borderline and doing these businesses and supposedly what is it? These are not third world countries. These countries are there for the money and I think already investment is somewhere in the area of about $5,000,000,000.

Because why? They want to get into the U.S. consumer market. These are not countries that are poor. They are in there for the money.

I am curious, how is this going to affect our situation of economic security here in the United States when everybody wants to get in? The Chinese are doing it so well. The Japanese are doing it okay. I mean how is this going to be for the American workers and their standard of living?

Mr. O'QUINN. Well, first of all from an economic standpoint and a security standpoint, we want a Mexico that has rising income and prosperity.

That alleviates pressure from illegal immigration and creates a better market for American goods and services. They are our neighbors.

If they stagnate or go backwards economically you risk the possibility of political disturbance or turmoil on our southern border. Therefore, it is in our interest that investment occur in Mexico and jobs are created in Mexico.

Mr. FALEOMAVAEGA. I still have a couple more questions, Mr. Chairman, but just one more.

You know there is a bank in India. I think there was a very recent article about what he did. He did not lend money to the rich guys. He lent money to the poor sector of the Indian communities and now I think this bank that this Indian fellow did and I wish I had the article with me——

Mr. HAGER. The Gremine Bank.

Mr. FALEOMAVAEGA. Was it Bangladesh?

Mr. HAGER. The Gremine Bank you are probably——

Mr. FALEOMAVAEGA. It was somewhere about $800,000,000 now in deposits with the purpose of lending money strictly to the poor people, not to the rich bankers and the guy that wants to make more money.

This fellow has been so successful at it and I was curious how the regional banks might also take this as an example of success where those who are really the low-income level are really getting the benefits because they really do well on this.

Mr. HAGER. Well sir, I know Mr. Bereuter has had a lot of experience on——

Mr. FALEOMAVAEGA. Or is that just an illusion?

Mr. HAGER. No. I think the notion of micro-enterprise and credit lent to small enterprises is——

Mr. FALEOMAVAEGA. I think it is Bangladesh.

Mr. HAGER. ——an effective means of economic development. I guess I share the hope that over the long pull as troublesome as it may be from moment to moment, that over the long pull the right model to look at is something like South Korea, whereas Secretary Lipton, I think, was using Korea as one of the examples.

Secretary Lipton referred to five IDA graduates now as constituting a market of $40,000,000,000 per year for American goods.

In answer to the larger thrust of your questions, what you hope happens here is that over time by investing in these less developed countries and assisting them to grow that you do in fact create populations with more money in their pocket and themselves become consumers and consume American goods. The $40,000,000,000 of exports from the United States then constitutes jobs back here.

So sometimes it is a difficult case to make plainly, but I think the theory certainly is that economic development abroad does result in enhanced well being here.

Mr. FALEOMAVAEGA. My concern with Mr. O'Quinn's statement about GATT and NAFTA, I guess is specifically about the fact that American workers are supposed to be trained now for better jobs and I wanted to ask Mr. O'Quinn if this in fact is happening.

My concern is that this is not happening. $16-an-hour workers now in America are losing their jobs and corporate America is now leaving and going to Mexico and these other countries where obviously because of cheaper labor costs they love it there.

Mr. O'QUINN. Well, the American labor market is very dynamic. Jobs are created and lost constantly and that really is its strength. We do not lock people in particular jobs until companies collapse and industries collapse. They are allowed to move on.

We have a very low unemployment rate as we have opened up trade. Many jobs are being created in the highest-paying job sectors.

There are problems, however, and I think you recognize them, and everyone would admit them. What do you do with a 50-year-old or a 45-year-old worker who did not complete a high school education and then got involved in an industry that is no longer able to sustain his employment?

I think there can be a legitimate rcle for retraining via education and investment in those workers so that they can move on to different jobs.

But the solution to that problem, as tragic as it may be in individual cases, is quite frankly that we have to keep the economy growing, first of all, and creating jobs. Having the right economic policies, we then have to deal specifically with making sure that those people whose skills are no longer in demand have access to our excellent technical colleges and university systems to get the training they need to move on to more and better paying careers. That is something that legitimately needs to be addressed.

Mr. BEREUTER. I did worry a little bit when you first started that you had been watching Ross Perot infomercials.

Mr. FALEOMAVAEGA. No, no.

Mr. BEREUTER. Has he asked you to be a running mate or anything?

Mr. FALEOMAVAEGA. I have read a couple of bad joke books and I wonder myself too on some of the conclusions that he has reached.

Mr. BEREUTER. It was interesting discussion on NAFTA and we are not here to talk about NAFTA, since it is not a part of a multilateral development bank, but an American international initiative.

But I cannot help telling you that it is creating jobs in my district. Net jobs and they are significantly well paying jobs. I have one or two more questions and then I will turn to Mr. Berman first or Mr. Faleomavaega.

China right now is absorbing a tremendous amount and even a very large percentage of World Bank lending as well as market rate lending from the Asian Development Bank. Gentlemen, is this trend sustainable? Should China graduate from concessional loans?

Mr. HAGER. Well, my personal view would be I agree with the U.S. position on that. That the answer is yes.

Further, my understanding is that to some extent that is really happening in the natural course of things, because if you look at the total portfolio of World Bank exposure in China, the blend is already hardening, as they would put it. There are fewer IDA concessional loans and more of the market rate IBRD loans in the mix.

The other point to make is that I am not familiar with the ADB's standard on this question, but I know the World Bank has a clear legal policy of limiting its exposure to any one country.

But as a very practical matter, they are pretty close to the limit on China. So they might go up and bump against the limit, but there is a limit and it does not keep on going up.

There are a few countries where the bank is heavily exposed and some of them, I would frankly say, reflect the political judgments. Mexico is a place where they are heavily exposed and so forth.

But it will not continue in the sense that the investment in China would pose a risk to the bank's portfolio in some sense or skew the allegations that resources are too much in the direction of one country. That is not permitted by the bank's rules.

Mr. BEREUTER. Mr. O'Quinn.

Mr. O'QUINN. I would agree that it is time China graduate from the concessional lending and do exclusively market rate lending.

I understand from what the secretary said and elsewhere that this is part of the 11th replenishment and will be the last exposure for those concessional loans. I think that is a correct policy. I think India should also move in that direction as well.

Mr. BEREUTER. All right. Mr. O'Quinn, you stated pretty clearly in your testimony that, "On balance however, they", meaning the IFI's, "have not been a good bargain for the American taxpayers in promoting economic growth abroad."

Strong statement. Are you differentiating whether or not there are bargains for American taxpayers in other kinds of objectives, because you specified economic growth abroad?

First of all, what would you say to sustain your position that it is not been a good bargain in terms of promoting economic growth and then do you think it is a bargain in any way?

Mr. O'QUINN. All right. That is a fair question. First of all, I would say that in terms of economic growth, the biggest problem I have is with policy, because I think if you get the policies right then the growth will follow.

I think that particularly in the 1970's and the 1980's there was less emphasis at the World Bank and the IMF, if you will, on market-oriented policies.

Mr. BEREUTER. So they could be a bargain for the American taxpayer if the policies were appropriately developed and implemented.

Mr. O'QUINN. If the policies are appropriately implemented I would agree it could be a good bargain.

Mr. BEREUTER. How in general would you like to see those policies changed so it becomes that bargain?

Mr. O'QUINN. Well, first of all I think that there has to be a tremendous emphasis on the legal infrastructure of a market. We have talked about these things: a fair judiciary, transparency.

Those things are absolutely crucial for a market economy to survive and prosper and I think that using IFI's leverage to achieve those objectives is something that would be useful for American taxpayers.

I think you have certain problems in terms of the way the IMF is conducted. Obviously this is the Asia Pacific Subcommittee. However——

I would use the example of Argentina though where they have gotten half the policies right. They supported privatization.

They have supported a lot of the initiatives of the government, yet at the same time there has been an over emphasis, as I have said, on reducing the budget deficit before you had a chance for some of these other policies to be set in place and produce the economic growth that will allow, if you will, the government employees that are going to be laid off to find jobs in the private sector.

Simply cutting back on government spending before you have a growing private sector in place to hire a people is a recipe for political trouble.

Mr. BEREUTER. All right. Thank you for that example.

Mr. Berman.

Mr. BERMAN. Mr. O'Quinn, you sound almost like an old Democrat.

Mr. O'QUINN. Maybe a pre-Roosevelt Democrat.

Mr. BERMAN. Although it is the second thing you said that gave me cause for concern, I want to make sure I understood you.

I drew an implication from what you said in response to Mr. Faleomavaega's questions that the way to deal with both the humanitarian and competitive aspects of horrible working conditions, very low pay in some of these developing countries is to promote their economic progress, because history shows us that as people get a little more of an economic stake, they start putting pressures on their government to start providing some minimum standards for working conditions, meaningful sanctions against child labor and wage.

You said that almost approvingly as if then those governments respond and that is good. I wanted to give you a chance to get away from that implication that I drew. That governments have a role to play in the protection of labor standards and wage rates and working conditions.

Mr. O'QUINN. Well, let me put it like this. We have a lot of evidence in terms of the environment, and certainly even someone as free market as I am recognizes when third parties are harmed that have not, if you will, consented to a contract, in the case of environmental pollution, that there is an appropriate role for government involvement or regulations that limit harm to third parties.

In environmental regulation, we have very clear evidence that when countries reach about $6,000 a year per capita income there is all of a sudden growth in spending on environmental problems and a growth in terms of environmental regulations and other things to alleviate environmental problems.

In terms of labor standards and practices, while I generally believe in a very unregulated labor market, of course I think there are some instances, for example with child labor, where you are not dealing with voluntary contracts between adults, that there may be a role for government intervention.

Now, it is also clear that in terms of child labor, as countries move up the per capita income standards, what was acceptable practice becomes unconscionable practice and even if laws were on the books before, there is a tendency to start enforcing those laws.

So what I would say to you, I am generally not for and I am certainly not going to argue for minimum wages. There are all kinds of other government regulation in terms of labor markets.

I think with the issue of child labor, which is a different type of thing because you are dealing with children, I think you will have more and better enforcement and more and better laws regarding that as you proceed up the income ladder.

Mr. BERMAN. It is not that far a step between the impact on third parties from relationships and contractual activities that occur and the status of children to some recognition that the bargaining leverage and negotiating contracts in many industries and many areas is not particularly equal.

The wonderful freedom to contract in the deregulated world is not always quite as fair as it might appear at first blush.

Mr. O'QUINN. Well, sir——

Mr. BERMAN. I think we are ranging back into domestic issues here.

Mr. HAGER. But if I could say, Mr. Berman, to bring it back to the issue of the potential utility of these multi-lateral institutions, I think it is fair to suggest that unfair labor practices in many cases, use of child labor and so forth, are likely to persist if there are no counter forces to prevent it.

There are certainly people who will attempt to exploit labor in a variety of ways in poor countries. So the hope here would be that by working through the multi-lateral institutions and having a presence there and offering frankly added capital to the economic development process, we could get in return commitments about issues like wages and working conditions and exert then some upward pressure now, not waiting for the marketplace to work in the good deliberate pace of time, but really putting pressure not in an upward direction on those——

Mr. FALEOMAVAEGA. Will the gentleman yield?

Mr. BERMAN. That is a point of divergence between the two of you I take it?

Mr. O'QUINN. Small.

Mr. FALEOMAVAEGA. I was just curious then commenting on Mr. O'Quinn's response is that I think we found in the history of our own country we had serious child labor laws and conditions that gradually evolved.

My concern is, are we just going to let this be taken by way of circumstance or should the government be playing a more active role in the process of making sure that this kind of thing does not become in and of itself or do you think that in due time this will eventually change because of the economic changes in the country?

Another concern is that waiting another 50 years in this abomination, is that the logic that Mr. O'Quinn follows? Let events take care of itself and child labor law will then just disappear just like in our own country.

Mr. O'QUINN. No. I would not say that. First of all in most countries you have laws against child labor. The problem in many third world countries in the very poorest of countries is those laws are not enforced.

You cannot get those laws enforced or it is very difficult to get those laws to be enforced when the choice is that the child labor is necessary to the parents or families to, if you will, make ends meet just to feed themselves.

That is not a very pleasant situation and it is certainly one in which we must think in terms of alleviating poverty and creating the economic growth, jobs, and the opportunities so that people are not forced in those circumstances.

But the ability to maintain and enforce those laws comes because there is sufficient wealth in society and a sufficient availability of jobs that people are willing to put pressure on the government to enforce those laws.

You can have all the laws on the books against child labor or all the labor laws or all the environmental laws on the books you want to, but if there is no public support for maintaining and enforcing those laws, they are not worth very much.

Mr. FALEOMAVAEGA. I think that is basically the situation we are in now. My understanding is that our country has been a great advocate of this problem and I think it ties into the regional lending institutions by way of economic development.

A question I raise is that when our country raises this issue in regional organizations the response even from some of our European friends, hey none of your damn business.

Now, we want to be successful economically in our ventures out there in those third world countries so do not talk to us about child labor.

Mr. O'QUINN. Well, in the long-term obviously it helps a country that its children are educated. In the example of Korea where you have universal primary, middle and secondary education, that speeds up the advancement up the economic ladder. So keeping children in child labor is not necessarily in the interests of the country.

Mr. FALEOMAVAEGA. And not a high priority among the regional lending institutions, I am sure.

Mr. HAGER. Well, there again I think we should bear in mind that the United States at present does have the largest, not a majority share by any means, but the largest single voting share in these institutions.

So my own view would be that your assessment of the importance of these kinds of issues is correct and the United States use its voice and vote, which is substantial in these institutions, to see that the institutions do what they can to ameliorate those problems.

Mr. FALEOMAVAEGA. Thank you, sir.

Mr. BEREUTER. I guess Mr. Berman said he has completed his questions, but we were just talking here as we were listening to you that our OPIC program is one of the bilateral programs where we have important labor standards as a part of it, and I am told environmental standards as well, so that you have a right to organize, for example, as a requirement for receiving assistance for loan guarantees going into that country. So it is interesting that we took the action we did yesterday in OPIC.

I will yield to you if you have any final questions.

Mr. FALEOMAVAEGA. I thank both gentlemen for excellent presentations.

Mr. BEREUTER. I do have one final question I wanted to ask Mr. Newendorp, but he is not here and so I will see if you have an answer to it, either of you.

Given the fact that we have arrearages, is there a serious threat about procurement cutoffs against American firms? Do either of you feel able to take a stab at that question? Are you familiar with the potential?

Mr. HAGER. My view would be I would try to be reassuring on your use of the word "serious". As I understand the deal which was negotiated by the Treasury with respect to IDA, it was only meant to be a kind of way of the United States trying to appear reasonable in the context of our apparent inability to pay off what we have already agreed to pay.

But it is a short-term deal. It was constituted as an interim trust fund, bridge fund kind of situation. There has never been any expectation or suggestion that going forward if the U.S. participates in the future in another IDA replenishment or certainly any of the other institutions that there be any limit on our procurement.

I think further it is my sense that the Administration has gotten the message from Congress that Congress is not happy that they were as reasonable in these negotiations as they were and perhaps they should have tried for a tougher bargain.

So I think they are going to go back and I would underline your use of the word serious and say no, I do not think there is going to be a serious future limit on procurement by U.S. companies.

Mr. BEREUTER. Mr. O'Quinn.

Mr. O'QUINN. I do not have anything further to add.

Mr. BEREUTER. The Senate apparently has recommended using the fiscal year 1997 appropriation of $700,000,000 for the World Bank for the interim fund instead of being used to apply to the arrearages, hoping that that makes it less likely that U.S. firms will be cut out of procurement opportunities. I am not sure what their thinking is on that, but I am told that is a factor.

Mr. HAGER. I am not sure how the mechanics of that would work out, but again my sense is that the Administration and through the

Administration our partners in IDA have gotten the message that Congress is not pleased with that. So I think they will act accordingly.

Mr. BEREUTER. Gentlemen, thank you very much for your testimony. I appreciate your thoughts as you have provided them to us in answering our questions, as well as your testimony. Thank you.

Mr. O'QUINN. Thank you.

Mr. HAGER. Thank you.

Mr. BEREUTER. The subcommittee is adjourned.

[Whereupon, at 3:30 p.m., the subcommittees were adjourned.]

APPENDIX

FOR RELEASE UPON DELIVERY

Expected at 2:00 p.m. EDT

September 12, 1996

STATEMENT OF TREASURY ASSISTANT SECRETARY

FOR INTERNATIONAL AFFAIRS DAVID LIPTON

INTERNATIONAL RELATIONS COMMITTEE'S

ASIA AND THE PACIFIC SUBCOMMITTEE

INTERNATIONAL ECONOMIC POLICY AND TRADE SUBCOMMITTEE

HOUSE OF REPRESENTATIVES

Thank you Mr. Chairman, it's a pleasure to appear before the subcommittees today to speak on international financial institution (IFI) lending to Asia and implications for U.S. interests in the region. These institutions have been active in the region for decades, supporting policy improvements and financing development in the region. With the sweeping changes in Asia and the globalization of markets, the role of the IFIs is changing. Today, I will discuss the three critical roles for the IFIs in Asia: to address the serious poverty needs of the area, to encourage market-based policies, and to encourage a stronger role for private sector activities in the region. But I will also stress that we must seek improvements in our international financial institutions so that they can be as modern as the markets in their member countries.

Let me begin by placing the discussion in the context of Asia's recent economic developments. Asia stands out among developing regions in its economic performance. With average annual GDP growth over the past two decades of about 7 percent, developing Asia has seen its economy quadruple in size during a period in which Latin America has not yet doubled. Living standards have improved steadily in East Asia -- per capita GNP rose by 6.4 percent per annum between 1980 and 1993 -- while living standards in Latin America and in Sub-Saharan Africa have stagnated.

Developing Asia has achieved a new prominence in the global economy -- now accounting for 23 percent of world GDP, compared to 21 percent for the United States and 9 percent for Latin America. While it is true that exports have played a key role in Asia's economic development, the steady improvements in living standards have created a huge and dynamic new market demand for imports as well. By total volume, developing Asia's imports have grown by an average of 10 percent per year over the past two decades, which has led to a seven-fold increase in imports. That compares to a mere doubling of imports in Latin America during the same time period. This year alone, developing Asia is expected to spend more than $1 trillion on imports for the first time, compared to $217 billion for Latin America. With a potential market of nearly 3 billion people, developing Asia represents an enormous economic opportunity for the United States, and one to which U.S. business is responding. At $271 billion in 1995, total U.S. trade with the region accounted for 20 percent of overall U.S. trade, and was only 3 percent less than the value of U.S. trade with Europe. Last year, U.S. exports to developing Asia accounted for 12 percent of their imports, with U.S. exports to most of Asia's developing economies expanding more rapidly than U.S. imports from these countries. That pattern will be reinforced by the continuing strong investment trend in Asia, which has pushed the region's aggregate current account into deficit.

While most Asian economies continue to do well, the region is not without its own set of concerns. Regional growth looks to slow by about 1 percentage point this year, and some countries have become concerned about an erosion of export performance and rising current account deficits. Some currencies in the region have come under pressure from the markets. We should remain alert to these developments. But there is some reason to view these developments as adjustments along a path to more sustainable output and trade growth trends. The modest slowdown in economic growth in some countries should allay fears about overheating. Growth rates in most of the leading Asian economies at or above 6 percent, remain the envy of many other regions of the world. The slowdown in export growth, which has attracted much attention, comes after several years of fast expansion, is related the slowdown in Japanese and European demand, and does not appear to reflect a fundamental problem of competitiveness.

The reasons behind Asia's past and continuing economic success are as many and varied as the countries themselves. The underlying common factor, however, is that Asia started from a very low base in terms of output per capita and pursued economic policies that promoted stability and growth. Public sectors have been kept small; for example, government spending in the newly industrialized economies (NIEs) took up only about 19% percent of GDP during 1991-95. Fiscal deficits have been kept under control, with all but India averaging less than 2 percent of GDP from 1991-95, and such economies as Hong Kong, Singapore, Thailand, and Malaysia in surplus during this period. Monetary policy has kept inflation under control, with all countries in the region except China averaging inflation rates below 10 percent from 1991-95. China itself is seeking to match this performance this year, having brought inflation steadily down from a high of nearly 22 percent in 1994 to roughly 7 percent in the first half of 1996.

Macroeconomic policy has been supported by a strong commitment to future growth -- reflected in strong investment in human and physical capital. Seven out of 10 key Asian economies had primary school completion rates of greater than 85 percent as of 1993, while six had secondary school enrollment rates of greater than 55 percent. Similarly, Asia has channeled enormous resources into physical infrastructure. The dramatic rise in foreign direct investment into Asia receives much attention, but it should not escape our attention that Asia would not have achieved an investment rate averaging 33 percent of GDP in the 1990s without its impressive record of consistently high domestic savings. With its aggregate savings rate in excess of 30 percent throughout the 1990s, developing Asia has been able to invest in itself year after year, building the kind of physical capital and infrastructure needed to sustain economic growth while also boosting competitiveness through increases in labor productivity.

Maintaining high growth may prove more difficult as Asia catches up. Asia has boosted productivity by providing workers with machinery and equipment and by importing technology. Many countries in the region will soon have to seek growth opportunities by competing with the world's technological innovators. In this context, more attention will have to be paid to such issues as copyright protection and building a strong network for research and development -- areas in which Asia is now weak.

Role of the IFIs

Asia was not alone as it pursued its development aims. The IMF, the World Bank Group and the Asian Development Bank and Fund have quietly and steadily supported Asia's economic transformation from the earliest stages -- often with impressive results. Two examples which I will discuss later are recent changes in India and the Philippines. Although the more dramatic changes in these two countries has occurred within the past five or six years, the IFIs have been actively providing policy advice and financing there for the past thirty years. The IMF in particular has consistently advised those countries that their development efforts would only succeed in a climate of market-oriented economic policies that stressed openness, currency convertibility, and a central role for the private sector.

Three economic realities on the ground in Asia will be driving the agenda for MDB action in the decade ahead:

(1) the pervasive poverty that exists in large parts of South Asia and in other areas;
(2) the continuing need for economic reform in several key countries; and
(3) the need to involve the private sector in promoting greater growth in critical sectors such as power and transportation.

Problem of Poverty

Despite the stunning economic success in some parts of Asia, large portions of the population still do not participate in the economic transformation that has been taking place there. More than half of the world's one billion poor people live in South Asia. For the most part, the poor are without clean water and sewerage and children lack basic health care and have very limited opportunities for education.

The flow of private capital that is now going to some of the rapidly growing countries in Asia is playing an extremely productive role in supporting economic development. We also need to keep in mind, however, that there are other counties in the region like Laos, Sri Lanka and Bangladesh do not have access to the world's private capital markets.

The key to the alleviation of poverty is equitable and self-sustaining economic growth. As the World Bank pointed out in a recent report on poverty, "No country has had a sustained impact on reducing poverty without continuing economic growth." As the "East Asian Miracle" has shown, the countries that have grown rapidly are the ones which have adopted policies in the areas of health, primary education (including the education of girls), and integration of the poor into the formal, private sector, which directly affect the poor. Other areas which are key to poverty alleviation are rural water supply, reforms in the agricultural area and micro-credits for the poor.

The means through which we can best promote sound policy in this group of countries is the World Bank's soft loan arm -- the International Development Association (IDA)-- and the Asian Development Fund (ADF). These resources are focussed on the neediest countries and directed at investments in human capacity building. But resource flows must also be linked to countries' efforts to deal more successfully with issues of economic growth and poverty reduction.

The MDBs already do a great deal of work which has a significant effect on poverty alleviation. In 1995, for example, 25 percent of the World Bank Group lending was directly targeted to help the poor. The comparable figure for IDA alone was 43 percent. This included commitments of $424 million for education in South Asia, $258 million for population, health and nutrition, and $276 million for water supply and sewerage. Comparable figures for the ADB in its borrowing countries (a larger area than South Asia) were $358 million for education, $448 million for water and sewerage, and $31 million for health and population.

Bangladesh, a densely populated country (120 million in a country smaller than Wisconsin) with social indicators much below those of its neighbors and more than half of its people living below the poverty line, has received substantial support from IDA, the ADF and other donors, for improvements in education. Over the past two decades, the primary school enrollment rate for young girls has doubled to 71 percent and now approaches the 83 percent rate for boys. A great deal of emphasis has also been placed on increasing the role of NGOs -- which are numerous and effective in Bangladesh -- to help women at the village level get better access to health services and education and micro-credit programs.

In Laos, where 1.5 million people (almost a third of its population) depend partially or wholly on slash-and-burn farming for their subsistence, IDA and the ADF have made integrated rural development the centerpiece of their country assistance strategy. The aim is to try to increase incomes in rural areas and help stabilize the rural population, giving these people a chance to break free from their subsistence pattern of life. Specific health and education programs are targeted at children in the hill regions, a particularly vulnerable group.

Overall, it is clear that greater investments will be needed in developing human capital in some of the poorer countries in Asia, if economic growth is to take hold. The International Development Association (IDA) and the Asian Development Fund (ADF) are taking the lead in addressing many of these problems.

The Need to Support Economic Reform

The second role for the IFIs is to continue to support economic reform. The IFIs have a record of solid accomplishments in this area. India, for example, began a comprehensive effort to reshape its economy at the beginning of this decade. Before 1991, India's planning approach to development had helped the country escape from massive illiteracy, recurrent famines, and secular stagnation, but it had brought with it heavy constraints as well. Planning had led to an over-extended public sector and had created severe financial imbalances which are yet to be fully overcome. India had also failed to deepen its ties to the world economy, with the result that India's share in world trade had dropped from 2 percent in the 1950s to less than one half of one percent in the 1980s. Protectionism had forced Indian consumers to pay higher prices for goods of lower quality, and deprived the country of the benefits of foreign investment. In short, it held back India's potential for growth.

In 1991, faced with severe fiscal and external balances and on the verge of defaulting on external debt obligations, a new government undertook the major task of stabilizing and liberalizing the economy. This quiet revolution was supported by assistance and advice from the international financial institutions. It has yielded impressive results. Thanks to stabilization and reform measures introduced with the support of IDA lending in 1991-92, India has made substantial progress in areas such as investment, trade, tax, exchange rate and financial sector policies. This has resulted in rapid growth of U.S. exports after decades of stagnation. In 1995 alone, U.S. exports to India climbed 44 percent. Growth rates in India reached 6 percent in 1994-95 and 7 percent in 1995-96.

But sustaining this growth will require further reform, and the MDBs will have an important catalytic role to play in supporting this process. India's reform agenda, on which it is closely working with the MDBs includes: reduction in the fiscal deficit, easing of infrastructure bottlenecks, liberalization of farm policies, intensification of financial reform, particularly in banking and insurance, and further cuts in tariffs to bring them down to the levels of competitor countries in East Asia and Latin America. Greater efficiency in agriculture is particularly critical because it is the key to continuing growth and the reduction of poverty in India. Improvements have to be made in the provisioning of services in rural areas. Private investment in the power sector would greatly benefit from additional reforms of the state electricity boards and better management of highway construction programs.

There have been other promising examples in the region such as the start of reform in the banking sector in Indonesia under an ADB loan in 1992, an IBRD privatization support project for telecommunications in Pakistan, and an IDA project in Sri Lanka for developing private sector infrastructure.

Korea is of course a dramatic example of a country that has undergone almost breathtaking change in the past few decades. Only 30 years ago, Korea's per capita income amounted to only $100. Today it is $8,500 and rising steadily. Korea's exports have climbed from only $43 million in 1962 to $96.4 billion in 1994. Although good policies and considerable bilateral assistance from the United States played an important role in the process, the IFIs were also there with advice and funding. The IMF and Korea had fifteen standby arrangements from 1965 to 1985. But, today, the IFIs have been able to pull out, graduate Korea, and direct their funds to others. In the period 1968 to 1972, lending to Korea represented 26 percent of total ADB lending and it was also a major borrower from the World Bank and IDA. Now Korea does not borrow from either the World Bank or the ADB; in fact, Korea is a donor country, albeit modest, to both IDA and the ADF. And it is well along the way in the accession process to the OECD.

China is another example of a country that, since opening its doors to the outside world in 1979, has made remarkable progress in its transition to a more market-based system. The international financial institutions have supported this process. In fact, China will soon graduate from the World Bank's soft loan window -- a step we have been pushing for -- due to a recognition that there are other borrowers in greater need of IDA's scarce concessional resources.

In dealing with China, U.S. policy is guided by three tenets: First, we believe that China's development as a secure and open nation is profoundly in our interest. Second, we support China's full integration with the international community. And third, while we seek dialogue and encouragement to manage our differences, we will not hesitate to protect our interests. As a result, our policy in the MDBs is to support only those projects benefitting China that meet basic human needs, or that promote market-oriented reform. When other MDB members have favored projects outside of that area, we have actively encouraged the institutions to undertake projects that promote market-oriented development, and to take account of the private sector capital flows which are increasingly available to that country.

Private Sector Development

This brings me to the third economic reality I want to emphasize today: how the MDBs should work more effectively through the private sector to promote greater growth in Asia. The MDBs still have substantial work to do in helping to create a fertile environment for the private sector, which is essential for equitable and self-sustaining economic growth led by private sector initiatives. This means a continuing important role for the MDBs in policy-based lending: encouraging borrowers to divest state-run enterprises, free up financial markets, enact legal and regulatory reforms, liberalize trade and investment regimes, and open up new opportunities in specific economic sectors such as telecommunications and transportation. Technical assistance programs should also be targeted to work more effectively in these areas.

Furthermore, in India and elsewhere in Asia, the work of the MDBs has to become more catalytic and more sharply focussed on helping to meet private sector needs; the use of guarantees should be broadened and other innovative instruments created to attract private investors to high priority sectors such as energy, transportation, communications, and finance. We are pleased with efforts now being made in this area by both the World Bank and the Asian Development Bank, efforts that directly reflect U.S. leadership. We want the MDBs to become more active in this area and to work more closely with private sector firms in developing new approaches, and they are responding.

The dynamic role that can be played by the private sector is very readily illustrated by the power sector in Asia. Faced with exploding demands for greater power and public sector enterprises that could not deliver, countries in the region had to look to the private sector for support. Private firms were seen more likely to implement power projects quickly and to operate them efficiently. They had better managers and greater technical capabilities and could introduce the critical element of competition.

That was the context in which the Government of the Philippines launched a new partnership with the private sector in recovering from the debilitating power shortage that prevailed in that country at the end of the 1980's. That power shortage was constricting economic growth and resulting in brownouts of between 4 and 8 hours each day in Luzon and up to 12 hours each day in Mindanao.

Thanks to this public/private sector partnership, the energy shortage was reversed in the early 1990's and the brownouts became a thing of the past. But that partnership could not have been developed without the preparatory work and participation of the ADB. Under the terms of a Build-Operate-Transfer (BOT) arrangement, negotiated in 1989, the ADB took an equity position of $1.0 million and made two private sector loans totaling $20 million to the Hopewell Energy Corporation for its Navotas Power project.

In 1993, the ADB approved another equity investment of $3.0 million and a loan of $26.5 million for a second power plant with the Batangas Power Company, with the Enron Corporation of Texas as a 50 percent shareholder and the main contractor for the project. Thereafter, ADB equity and loan financing followed for a third private sector power project, a coal-fired plant in Pagbilao. In this series of operations, ADB participation was considered the essential ingredient in a strategy that gave greater confidence to other lenders and created a favorable environment for further private sector activities in the Philippines.

The IFC and MIGA, the private sector and insurance arms of the World Bank Group, have long played a strong role in Asia. Last year (World Bank fiscal year 1996), total financing for the IFC's own account in Asia was just under $700 million, triggering total private investment in excess of $4.5 billion. In Thailand, for example, the IFC is helping to finance a private sector mass transit system for Bangkok, thereby helping to alleviate that city's serious air pollution and congestion problems. This is the first new privately-owned mass transit system anywhere in the world in many years. An example of a MIGA political risk guarantee issued in Asia in 1996 is a project to be undertaken by an affiliate of General Electric (U.S.) which will construct and operate two electrical generating plants in Indonesia. The project will help alleviate the frequent power shortages which are hindering Indonesia's economic progress.

The World Bank itself is involved in catalyzing private sector flows through its cofinancing operations. In its fiscal years 1994 and 1995, for example, it cofinanced 14 private sector operations in South Asia and East Asia and the Pacific, supporting total private sector financing of $2.3 billion.

Future Developments in the World Bank and the Asian Development Bank

As I have outlined above, both the World Bank and the Asian Development Bank, through their concessional and ordinary capital operations, are playing a uniquely important role in the three main areas I outlined: poverty alleviation, economic reform and catalyzing private sector investment in the region. We applaud their efforts, but do not want them now to rest on their laurels. When I said before that I want the banks to be as modern as the markets, I mean that they must be ready continuously to adapt to changes in the region, be able to assess their own effectiveness, discard policies and instruments that do not work and develop innovative and effective new instruments.

We have worked very closely with the World Bank in the past few years as it had undergone a major reform effort to improve the effectiveness of its operations in all countries. This reform process grew out of the 1992 Wapenhans Report, which had strong U.S. support. We have encouraged the World Bank to develop a strong internal evaluation system, and have supported its efforts to improve project design, implementation and monitoring. Another key element in the Bank's reform process are the Country Assistance Strategies, which ensure that individual Bank activities in a particular country are part of a comprehensive strategy that ensures sound market-oriented development policies. We will also be strongly pushing the World Bank to follow through with its stated commitment to base lending on borrower performance. Finally, we are encouraging greater World Bank use of guarantees, insurance and other mechanisms that can catalyze greater private sector investment in the region.

We are also pushing the ADB to make greater use of guarantees and other innovative financing to attract private sector financing into the region. But as I have said, the private sector is not the solution for all of Asia's problems at this time. We have also urged the ADB to increase lending in areas with great economic return but where private sector financing is not feasible. As a result, the ADB is increasing investments in human capital development, economic opportunities for the poor and the environment. To deal with the environmental needs of the region, it has adopted or revised a broad range of policies including energy efficiency, population and forestry. I am particularly pleased that the ADB has adopted a new policy on governance with a well-defined focus on participation, transparency, accountability and predictability.

We have an opportunity to build on this major reorientation of the ADB's operations. Negotiations are underway on a replenishment of the Asian Development Fund. Prudent management of ADF resources has permitted a one-year extension of the current replenishment but current estimates are that resources will be exhausted by the end of this year. We plan to focus this replenishment, which would cover the four-year period 1997-2000, on optimizing the efficient use of existing resources and reducing the need for "new" money from donors. One of our major goals for the ADF is to create the conditions, through improved and innovative financing arrangements, to put the ADF on a self-sustainable basis within half a generation. This is well within reach, but U.S. leadership remains essential.

Conclusion

Sound macro-economic policies, a clear focus on reducing poverty and increasing participation by the poor in market economies, and promotion of private sector activity are key to developing Asia's efforts to sustain healthy economic growth. The MDB's unique capabilities to support and help coordinate these three tasks is the value the MDBs bring to the development process in the region.

At a relatively modest cost to the United States, the MDBs have mobilized financial resources for international development from other countries and from private capital markets throughout the world. They are now extending their financial reach through more effective economic policy reforms in borrowing counties and by more innovative work with private sector entities. Through their promotion of growth and development, the United States has gained stronger partners in the global economy. It is worth noting that, in 1995, U.S. exports to the 70 "IDA eligible" countries totaled $25.5 billion, whereas U.S. exports to the twenty IDA graduates totaled $61.3 billion. Of the Asian IDA graduates, the U.S. export total in 1995 was $40.5 billion. It is difficult to see a more cost-effective way to advance high priority U.S. interests in Asia without these institutions. We are committed to using our leadership role in these institutions to ensure high quality, effective programs which ensure market-oriented development and a key role for the private sector.

Testimony of Robert P. O'Quinn
before the Subcommittee on the Asia-Pacific
of Committee on International Relations
U.S. House of Representatives
Thursday, September 12, 1996

Thank you, Mr. Chairman and members of the Asia-Pacific Subcommittee, for inviting me to testify today about international financial institutions. As a former Congressional staffer, I know how much Members appreciate brevity from the witnesses on second panel in an afternoon hearing. So let me cut to quick.

For the United States, the most important issue regarding international financial institutions is whether they provide a cost effective means of accelerating growth in developing, least developed, and transition economies. Promoting economic growth abroad is an important American foreign policy objective. Of course, economic growth abroad expands the market for U.S. exports and thus creates jobs for American workers. However, economic growth has geo-political as well as financial benefits for the U.S. As we learned in the 1930s, economic stagnation and dislocation can breed international instability that may directly threaten American security interests. Promoting economic growth can lessen tensions that might lead to conflict.

The record of international financial institutions in promoting growth in developing, transition, and least developed economies is not good. Certainly, some of the activities of the IMF and multilateral development banks have been helpful. On balance, however, they have not been a good bargain for American taxpayers.

IMF. The International Monetary Fund (IMF) is an international monetary institution established at the Bretton Woods Conference during 1944. After President Nixon's delinking the dollar from gold eviscerated the IMF's original mission to maintain currency convertibility under a gold exchange standard, the IMF adopted two new missions: (1) an international short-term "lender of the last resort" to governments in developing, least developed, and since 1989 transition countries and (2) an economic policy advisor to those governments.

Playing "lender of the last resort" role to over-extended foreign governments may sometimes be necessary to avert an international financial crisis. However, it is the IMF's policy advice that has done the most damage to prospects for economic growth in the world. On one hand, the IMF advances many of the key principles of market economics. For example, the IMF consistently favors deregulation, privatization, and trade liberalization.

On the other hand, the IMF emphasizes closing government budget and current account deficits. Frequently, this obsession leads foreign governments to hike taxes in an often vain attempt to close these twin deficits.

Higher tax rates may slow or even halt economic growth. Certainly, this reduces imports and narrows the current account deficit. However, the effect of slower economic growth on tax collections often overwhelms the effect of higher rates, thus causing the budget deficit to rise.

Moreover, the IMF pushes foreign governments to cut public spending and employment. While such reductions are desirable in the long run, they may prove politically unpalatable when combined with higher taxes, recession, and unemployment in the short run. Thus, the IMF's push for immediate budget deficit reduction may cause a populist backlash against free market economic policies that will produce high growth rates over time.

World Bank. The World Bank is a multilateral development bank that was also established at Bretton Woods. The World Bank has four aid "windows." Funded through borrowings on international capital markets, the International Bank for Reconstruction and Development (IBRD) makes market-based loans to middle income countries. Funded by foreign aid triennal contributions from the U.S. and other rich countries, the International Development Association (IDA) assists the poorest countries by providing interest-free loans with maturities of up to 40 years. In addition, the International Finance Corporation (IFC) provides market-based loans to private enterprises while the Multilateral Investment Guarantee Agency (MIGA) insures private investment in developing, transition, and least developed economies.

In recent years, a number of serious problems have beset the World Bank. These problems raise serious questions about the World Bank's financial solvency and effectiveness in promoting economic growth.

The World Bank displays a key weakness that is inevitably found in the *post-mortem* of any failed financial institution: poor management controls. In 1992, an internal report prepared for then President Lewis Preston found the World Bank loan evaluations had a "systematic and growing bias towards excessively optimistic rate of return expectations at appraisal." The World Bank had an "approval culture" in which "staff perceive appraisals as marketing devices for securing loan approvals." Moreover, the World Bank failed to monitor projects and enforce financial covenants on borrowers. Consequently, the report found that one-third of the Bank's projects were failing and the quality of Bank's loan portfolio was steadily deteriorating.[1]

The World Bank began to shift its portfolio from project financing to non-specific structural adjustment loans during the Third World debt crisis of the 1980s. Those loans now comprise one-fifth of the IBRD's portfolio. While such loans may, in theory, facilitate a transition to a more market-oriented economy, these loans are too often merely used to keep existing creditors at bay.

Moreover, the Reagan and Bush Administrations used the IMF and the World Bank to advance funds to heavily indebted governments. This allowed these governments to reduce their balances or even pay off their loans to private banks in Europe, Japan, and the U.S. Thus, advances from the IMF and multilateral development banks gradually replaced commercial bank loans.

The World Bank has benefited from the Paris Club, a regular meeting of heavily indebted and lending countries sponsored by the French Ministry of Finance to renegotiate Third World debts, and the IDA to maintain the appearance of the IBRD's loan portfolio. Through the Paris Club, the U.S. and other creditor governments have forgiven debts owed to

[1] Patricia Adams, "The World Bank's Finances: An International S&L Crisis," *Policy Analysis*, No. 214, October 3, 1994, pp. 5-6.

them so that Third World borrowers would not default on their IBRD loans. Moreover, the IDA has regularly advanced concessionary credits to "ease the debt service burden" of IBRD borrowers. Thus, the World Bank channels foreign aid money from rich countries through its subsidiary, the IDA, to heavily indebted developing countries that, in turn, use this money to pay the interest and principal on their loans from another World Bank subsidiary, the IBRD.

While such "round tripping" may forestall a day of financial reckoning at the World Bank, it does nothing to promote growth in developing, transition, and least developed economies. Consider the following:

- Of the 66 less developed countries receiving money from the World Bank for more than 25 years, 37 are no better off today than they were before receiving such loans.
- Of these, 20 are poorer today than they were before receiving World Bank loans.

The key to economic development in the Third World is private sector savings and investment, not foreign aid. Governments in developing, transition, and even least developed countries need to get their economic policies right. A low, flat rate tax structure, a fair legal code, an impartial judiciary, reasonable regulations, stable money, and borders open to international trade and investment all foster private sector savings and investment and thus accelerate economic growth. International financial institutions have value for the United States only to the extent that they advance these pro-growth policies.

Mr. Chairman, I thank you for your time and look forward to your questions.

TESTIMONY

Submitted by

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before a hearing
of the Subcommittees on

Asia and the Pacific
and
International Economic Policy and Trade

of the
House Committee on International Relations
U.S. Congress

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Mr. Chairman, I appreciate the opportunity to testify before these two subcommittees on a very important issue. In addition to my current work as an attorney in the private sector, I had the privilege in the late 1980's to serve as Staff Director of the House Banking subcommittee which had jurisdiction over U.S. participation in the multilateral development banks, where Mr. Bereuter was at the time the Ranking Minority Member. Therefore I know of his longstanding interest and expertise in this area, and I am honored to testify at his invitation today.

The subject of international institution lending in Asia and its implications for U.S. interests is extremely important. Many discussions about the multilateral institutions, in this case principally the World Bank and the Asian Development Bank, focus immediately on questions of economic development policy. But it is crucial to take one step back and look at the underlying reasons why the United States should care about, and actively support, economic development in all regions of the world, certainly including Asia.

The World Bank, the first of the multilateral development banks, and each of the MDB's created since in the last 50 years, are dedicated to the goal of economic development--globally in the case of the World Bank, and regionally, in the case of the others, such as the ADB.

Why should that goal be important to the United States? Because the history of major conflicts in the 20th century, among other evidence, suggests that enduring economic deprivation and inequitable distribution of wealth both within and among nations are destabilizing factors. Conversely, economic development and efforts to foster the equitable distribution of wealth within and among nations are stabilizing factors in world affairs.

During three major conflicts and on numerous other occasions since the early 1900's, U.S. troops have been drawn into active combat in Asia, and the case could easily be made that the greatest American sacrifices in terms of lives lost and days spent in military service have been and may in the future be in the Asia-Pacific region. And those conflicts have had economic roots, either in terms of fights over the control of known economic resources or the imperial ambitions of nations which seek to gain future economic advantage through territorial hegemony.

It is thus in the direct and clear interest of the United States to promote broad economic development, equitable distribution of wealth and an international economic system which is open to all and conducive to the peaceful, commercial--rather than the military-- pursuit of economic gain-- globally, but again, certainly in Asia.

In current terms, the simple reality is that if the lack of economic development in some parts of Asia persists (as in other regions of the world), that lack of development may result in either internal disorder in some nations or in warfare among nations which will almost inevitably have negative consequences for the United States, as the sole remaining global superpower which, by default, has a global peacekeeping responsibility, not to mention specific treaty obligations and standing armies in the Asian region.

In addition, I would subscribe to the notion, exaggerated at times but still basically valid, which has been aggressively advanced by the past two Administrations, those of President Bush and Clinton, that it is in the interest of the United States to develop global markets. It is my view that the multilateral institutions help to promote the kind of national economies that are in fact attractive markets for U.S. exports and investment.

That positive view of the role of the World Bank and other MDB's is a general one, but based on some specific observations:

* Economic development requires money. Building infrastructure and hiring workers to start enterprises requires capital. And that is what the MDB's have to offer. They are mandated to lend and invest where the private sector alone might not, given the alternatives open to private capital in more established, "developed" economies.

In recent years, the World Bank alone has invested some $9 Billion per year in Asia, including, for example, the $25 Billion of commitments made to date by the World Bank in China (PRC). It may not be true that every dollar of that money was well invested, but it is clearly true that that money has had economic development consequences which are significant, and would not have occurred absent the existence of these institutions.

* Increasingly, World Bank and other MDB involvement in development projects mobilizes private capital, thus accelerating the economic development process which is the goal. One of the trends since roughly 1985 when the World Bank began to emphasize "co-financing" is that the MDB's function de facto as part of a syndicate or consortium of financing, with the presence of the World Bank (or ADB) in a project operating as a kind of "good housekeeping" symbol which pulls in other investors. More recently, the increased use of the World Bank's guarantee authority has had the same impact.

Using those financial techniques, private capital is mobilized, and the result is that more capital is available for development in these higher-risk economies than would have been available otherwise--and indeed more capital is made available than the MDB's themselves could provide, standing alone. It seems clear that this trend will continue, as it should, thereby multiplying the impact of the U.S. taxpayers' commitment to the MDB's.

* The World Bank and the other MDB's are governed by their member nations, led in crucial respects by the United States, which to date has the largest voting share in all of the MDB's. Thus the U.S. "voice and vote" in a range of critical areas, including environmental consequences of projects, human rights concerns, and the recognition of labor rights, offers the prospect of channeling development capital into projects which are comparatively sound in terms of those considerations.

* As the World Bank raises those kinds of issues and creates standards by which to measure the performance of projects--for example in the

environmental area--those standards become a type of "best practices" benchmark which other capital sources, both public and private, look to in order to ensure that their investments are being made in accordance with both solid profit-seeking criteria and sound public policy considerations. For example, the U.S. Export-Import Bank has drawn extensively on World Bank environmental standards for projects in devising Ex-Im's own environmental guidelines, in response to Congresssional directives.

* Likewise, in terms of the U.S.'s trade interests, it is important to note that the World Bank and other MDB's can perform--and should be encouraged to perform--a convenor role for capital which ensures that trade and investment in developing nations, in Asia and elsewhere, are conducted on the basis of fair and transparent transactions.

The Congress, and Members of this Committee specifically, have expended considerable energy over the years concerned with questions of tied aid and the fairness of procurement decisions. The thrust of those concerns has been to assure that U.S. companies get a fair shake--that the best and most competitively priced product or service should win the contract, without favoritism based on national preference, corruption or any other trade-distorting factor.

While the World Bank's procurement process may not have been perfect in that regard, I believe it is clearly a model which attempts to ensure fair competition among international bidders, and again it is quite clear that OECD export credit agencies and others look to the World Bank's procurement and competitive bidding procedures as models which can be and are followed to ensure that unfair tying of aid and other trade-distorting practices are eliminated.

This role of the World Bank and other MDB's reinforces their role as mobilizer of private capital, providing all those investing in development projects with improved assurances that the projects will be managed in a transparent, non-corrupt, and economically efficient manner. That lofty goal has not been achieved in every case, by any means, but the MDB's can help push toward its achievement, and U.S. policy should be to encourage them in that effort.

Criticisms/Recommendations

Having made those positive observations about the MDB role in mobilizing capital for economic development in Asia and elsewhere--on terms that are fair, non trade-distorting and supportive of sound environmental, human rights, labor rights and other important values--let me make a few constructive criticisms/recommendations regarding the MDB's.

First, despite lingering concerns about the quality of the World Bank's loan portfolio, brought to public attention by the Wappenhans report, there is an argument that the World Bank has been too cautious over the years, and too prone to take its biggest stakes in countries which are seen as "hot" emerging markets where private capital may already be comparatively interested in investing.

Whether or not the Banks actually provide "additionality" to particular projects' and countries' development is a constant question, and one that can only have a case-by-case answer. But it seems fair to suggest that the World Bank goes too far in its recurring pride, regularly enunciated in its annual reports, that it never fails to be repaid and that it consistently turns a profit, in fact typically a rather large profit in nominal dollars, based on its large asset base and careful attention to its own investment strategy.

A development bank probably ought to lose some money now and then, otherwise it does not appear to be on the edge enough, taking chances to encourage development where it is needed and where the results are not yet proven. The Bank will argue of course that it cannot jeopardize its bond rating and its access to the private capital markets where it raises the money it actually lends, but again it is a question of degree. It would take substantial losses before the Bank faced a material shift in its borrowing costs, and even a few basis points might be a justified cost of doing business. To insist on the point, the MDB's are supposed to be development institutions, operating ultimately not to make a profit as a commercial bank attempts, but to achieve results in those economically distressed nations of the world which need help.

This is obviously closely linked to the question of where the Bank tends to invest. It is arguable that the Bank has made its biggest commitments in precisely those economies which have piqued the private markets' attention. The magnitude of the Bank's exposure in Mexico, Brazil, Indonesia, China, India and Eastern Europe raises that question. If the Bank can defend the proposition that its role in those countries has been precisely that of mobilizing and attracting private capital (along the lines I discussed earlier), then its country allocation of its lending can be defended; otherwise, it cannot be defended consistent with its mission as a development bank, not a for-profit commercial bank.

In any event, this issue does underscore the validity of insisting that countries such as China (PRC) and India "graduate" from the concessional lending made available by the IDA component of the Bank, and eventually from all MDB borrowing, in the case of economic success stories such as Korea. Despite controversy on the point, including here in Congress, it is my understanding that there is now a consensus on this issue, with timing being the only question. The Bank's lending to China already has "hardened," with the mix between concessional IDA and market-rate lending having shifted to the latter and with elimination of IDA lending to occur in the foreseeable future.

Second, the Congress should be aware of some implications of one of the most important recent trends in MDB activities. Like the major export credit agencies such as U.S. Ex-Im, and in some cases in conjunction with them, the MDB's are increasingly involved in project finance arrangements which feature lending which is expected to be repaid on a limited recourse basis, through the use by the debtor of the cash flow generated from a project in order to repay its financing. This differs certainly from the rapid-disbursing, policy-based lending and it differs also from the historic MDB approach of lending strictly to sovereigns, and relying on the sovereign status of its loan recipients as a major guarantor of eventual repayment.

With increasing privatization in many developing and former command economies, the trend is toward more lending which relies on private sector performance and the actual financial success of a project in generating cash flow to repay the loans. At the same time, however, the behavior of the governments with respect to the projects may be crucial. Electric power generation is a clear example. The estimated need for electric power in Asia is astoundingly large, based on both rates of economic and population growth. As major new power projects are built, limited recourse project finance is frequently being utilized.

This means that on the one hand, those involved in financing the project must make accurate judgments about the creditworthiness of the project owners and managers, including private rather than sovereign entities. And of course the lenders/investors must correctly guage the economic viability of the power plant. But this likely also means ensuring that the host government will pursue rational regulatory policies, including notably in the rate-setting area, which will allow the plant to be profitable. If huge investments are made in a power plant in Indonesia or China, but the government--irrespective of whether the plant is publicly or privately owned--chooses for political reasons to hold down electric power rates, the financial viability of the plant, and the long-term ability of the borrowers to repay its financing, can be jeopardized.

All of this supports the wisdom of the MDB's, the World Bank in particular, playing the kind of catalyzing role discussed earlier, where multiple investors from both public and private sectors are pulled together in investment consortia. Multiple investors from several countries spread the risk of big projects, like power plants. The World Bank presence in those deals can be used to ensure that the host governments have made credible and binding commitments which will be necessary for the long-term success of the project. And, as noted earlier, the MDB's can and should be the source for establishing standards in crucial areas such as environmental degradation, treatment of workers, humane resettlement, fairness in procurement and the avoidance of corruption.

If the MDB's refuse to participate in projects unless all parties from the various investing countries, and the host government itself, commit to abiding by "best practices" in these key areas, the MDB's can be a powerful global influence toward raising the standards in all countries, with positive results both in terms of conditions for the citizens of the developing countries and in terms of eliminating the unfair trade competition that can come from low-wage developing countries where at least minimum standards regarding working conditions, labor rights, the use of child labor and prevention of environmental degradation are not met.

Third, I would like to emphasize two particular items on the "report card" of best practices which the MDB's should be encouraged to promote: the elimination of corruption. Bribery, kickbacks and special financial arrangements made to obtain contracts both from government officials and private corporate individuals are a problem in many parts of the world. Corruption is economically inefficient and trade-distorting, and it certainly is inconsistent with the norm of transparent, fair and accountable government which is part of our notion of democracy.

The United States has been a leader in this area, first with the passage of its own Foreign Corrupt Practices Act to bar such corrupt activities by our own business people. More recently, Secretary Kantor has made prominent public statements about the importance of this issue, and the OECD has worked to raise the level of attention to this problem.

In my view, the MDB's are well positioned to assist in this effort by being aggressive not only in insisting that transparent and honest contracting and procurement practices be followed in the specific projects where they are lenders and investors, but that the companies and governments with which they do business demonstrate a commitment to the elimination of corruption, by having sufficient laws and corporate rules in place and by showing that they are enforced.

Likewise, the second item on the report card where I believe the MDB's, as well as the IMF, should be encouraged to do more, is in the area of curbing military spending by developing nations. Military spending is frequently a wasteful misallocation of a developing nations' limited financial resources, and often is engaged in by governments either for self-aggrandizement or, in far too many cases, to have a greater armed capability to suppress their own populations.

To the extent that money is fungible, government funds spent on military weapons are not available for health, education and economic development. Therefore the MDB's--and certainly the taxpayers of the U.S. and the other contributing members of the MDB's--are entitled to decline to fund projects in those nations where the host governments are misallocating their scarce financial resources in this way.

In recent years, in part based on Congressional interest in this topic, but also under the leadership of Managing Director Camdessus, the IMF and the MDB's have paid more attention to this question, but more should be done by the IFI's, and the Congress, through the U.S. Executive Directors in these institutions, should encourage them in this direction.

Fourth, the MDB's should be encouraged to expand efforts to foster the growth and maturation of vibrant NGO communities in the developing nations. American democracy thrives in part because of our concept of a civil society in which citizens are active not just as voters and as taxpayers but also through a wide range of private voluntary organizations which seek to promote particular agendas which their members freely choose. Such NGO's can be very effective watchdogs of government, as in the human rights and environmental areas, and they can be more effective in getting some types of tasks done than government agencies. Thus they should be encouraged and developing nations' governments should be assisted in creating the legal, tax and funding frameworks which permit and encourage them to operate.

While the World Bank has not always had a happy relationship with the NGO community, particularly in the environmental area, the Bank should be prepared to recognize that NGO criticism can be a useful cross-checking device to raise important questions and make sure Bank policies are on track. As Members of Congress know, being a public official requires a thick skin and a willingness to endure criticism, and in that spirit the MDB's should be supportive of the broad development of active NGO communities in developing nations.

Fifth, the Bank should also be encouraged to further decentralize its staff and increase its permanent presence in the countries where it is heavily engaged. Congressional and other critics often complain about the size of the Bank's staff, and even though each new Bank President seems to announce a reorganization that includes some downsizing, the Bank retains a very large staff, as well as an expanding physical complex, here in Washington.

By contrast, its permanent staff in the field does not always appear sufficient. For example, to manage and supervise the $25 Billion portfolio the Bank has in China, there is only a staff of 70, all located in Beijing. Shifting more of the Bank's personnel to the field would greatly increase the Bank's hands-on ability to manage its loans, especially in the case of large projects with complex financing arrangements, to assess new lending proposals and to pursue the kinds of broad policy goals in these countries that I have advocated here.

Conclusion:

Efforts to promote economic development through investment in developing nations plainly is controversial in the Congress, as evidenced by the OPIC vote just yesterday. But the wiser view is that long-term economic development, and efforts to spread wealth more equitably among and within nations, is a prerequisite for global stability, notably in a region such as Asia.

In addition, economic development efforts in the developing world which are accompanied by policies which evidence concern for the environment and which promote improved working conditions and long-term movement toward higher wages in those countries are beneficial to U.S.

citizens in a dual way: both in creating new markets with an appetite for and the financial means to buy American goods, and also by progressively eliminating the low-wage and environmentally destructive production of goods which can unfairly compete with American products.

The World Bank and Asian Development Bank can make positive contributions to achieving those goals, and they merit continued U.S. official and financial support. To the extent that there continues to be a bipartisan commitment to a balanced budget which will likely result in declining direct U.S. financial commitments to assisting in foreign economic development, these multilateral organizations plainly become even more important, since, as it is well understood, they leverage other official donor money from other countries, and, as discussed here, increasingly function as a catalyst for private capital flows.

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